

ST 07-20

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE,
Taxpayer**

**No. 00-ST-0000
IBT# 0000-0000
NPL# 0000
FEIN# 00-0000000
NOD# 0000**

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General George Foster on behalf of the Illinois Department of Revenue; John Doe, *pro se*.

Synopsis:

This matter is before this administrative tribunal pursuant to John Doe's protest of Notice of Penalty Liability ("NPL") number 0000, and Notice of Deficiency ("NOD") number 0000, as responsible officer of ABC LLC (hereinafter "ABC"). The NPL represents a penalty liability for Retailers' Occupation and related taxes for the period November 2002 through February 2003 and May 2003, while the NOD represents a penalty liability for withholding taxes for the third and fourth quarters of 2002. A hearing was held on this matter on July 11, 2007, with John Doe, the Treasurer of ABC, providing oral testimony. Following the submission of all evidence and a review of the

record, it is recommended that the NPL and the NOD at issue in this case be finalized as issued. In support of this recommendation, the following "findings of fact" and "conclusions of law" are made.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of Notice of Penalty Liability No. 0000, issued on January 13, 2004 to John Doe ("Doe") as responsible officer of ABC LLC ("ABC"), showing a total liability due and owing in the amount of \$35,455.27 for the period November 2002 through February 2003 and May 2003. Department Exhibit ("Ex.") 1.
2. ABC, an Illinois limited liability company domiciled in this state, operated a restaurant in Anywhere, Illinois during the tax period in controversy. Taxpayer's Ex. 1 (copy of ABC's completed form NUC-1 Illinois Business Registration); Taxpayer's Ex. 2.
3. ABC applied for an Illinois license to conduct business by completing and filing a form NUC-1, Illinois Business Registration, with the Department in February 2002. Taxpayer's Ex. 1.
4. The aforementioned NUC-1 filed by ABC listed Jane Doe as President and Secretary, and Doe as Vice-President and Treasurer of the corporation. *Id.*
5. Jane Doe signed a section of the NUC-1 form which provided "I accept personal responsibility for the filing of returns and the payment of taxes due." *Id.* On the last page of the form, Jane Doe signed her name under a statement that provided,

"Under penalties of perjury, I state that I have examined this application and, to the best of my knowledge, it is true, correct and complete." *Id.*

6. In addition to being the Vice-President and Treasurer, Doe also held the title of manager and managed the day-to-day operations of the restaurant owned by ABC. Tr. p. 14. His duties included filing the corporation's sales and use tax, and other tax returns and routinely signing checks to pay bills for operating expenses. Tr. pp. 15-17.
7. ABC maintained corporate bank accounts at the Bank and at Bank 2 throughout the tax period in controversy. Tr. pp. 14, 15. Doe had the authority to sign checks for the corporation drawn on either of these accounts, and routinely signed corporate checks when necessary to pay bills for day-to-day operating expenses. Tr. pp. 15, 16.
8. Doe signed the corporation's November and December 2002 and its January 2003 Illinois sales and use tax returns (forms ST-1). Department Ex. 2.
9. Throughout the tax period in controversy, Doe had knowledge that the corporation had sales and use tax obligations to the state of Illinois that were not being paid. Tr. pp. 16, 17.
10. ABC did not pay the amount shown due on its November 2002 through January 2003 Illinois sales and use tax returns. Compare Department Ex. 1 (copy of NPL) and Department Ex. 2 (ST-1 sales and use tax returns filed by ABC).

11. A Discharge of Debtor order granting a discharge of certain personal liabilities under 727 of title 11, United States Code, (the Bankruptcy Code), was issued to Doe on August 30, 2004.¹ Taxpayer's Ex. 2.

Conclusions of Law:

The issue in this case is whether John Doe ("Doe") was a responsible person who willfully failed to file and pay retailers' occupation tax and withholding tax for ABC LLC ("ABC") as required by statute. The admission into evidence of the of Notice of Penalty Liability number 8781 establishes the Department's *prima facie* case with regard to both the fact that Doe was a "responsible" officer and the fact that he "willfully" failed to file and/or pay taxes that were due. Branson v. Department of Revenue, 168 Ill. 2d 247, 261-62 (1995). When the Department establishes its *prima facie* case, the burden shifts to the taxpayer to overcome the Department's finding. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st District 1978). To overcome the Department's *prima facie* case, the taxpayer must present consistent, probable evidence, closely identified with books and records. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968); Central Furniture Mart v. Johnson, 157 Ill. App. 3d 907 (1st District 1987); Vitale v. Department of Revenue, 118 Ill. App. 3d 210 (3d District 1983). Oral testimony without corroborating books and records is insufficient to overcome the Department's *prima facie* case. Mel-Park Drugs v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991).

¹ Doe's Exhibit 2 shows a chapter 7 discharge order entered by the U.S. Bankruptcy Court on August 30, 2004. When a business debtor is required to collect and withhold a tax for which the debtor is personally liable, such a tax liability is never dischargeable. In Re Torres, 117 B.R. 379, 384 (N.D. Ill. 1990). Accordingly, Doe's NPL and NOD liabilities at issue in this case were not discharged pursuant to the Discharge of Debtor order entered by the United States Bankruptcy Court.

There are two types of taxes at issue in this matter. Doe has timely protested a Notice of Deficiency issued in this matter imposing personal liability pursuant to section 1002(d) of the Illinois Income Tax Act for the failure to pay withholding taxes. 35 ILCS 5/1002(d). The Department's *prima facie* determination of liability pursuant to section 1002(d) evidenced by Notice of Deficiency number 0000 has not been contested by Doe in these proceedings² and therefore is affirmed in its entirety. 35 ILCS 5/904; Branson, *supra*.

In addition, the Department seeks to impose personal liability for failure to remit Retailers' Occupation and related taxes ("ROT") to the Department for the period 11/02 through 2/03 and 5/03. The personal liability penalty for the ROT violation determined by the Department is imposed by section 3-7 of the Uniform Penalty and Interest Act ("section 3-7"), which provides as follows:

(a) Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon.
35 ILCS 735/3-7

An officer or employee of a corporation may therefore be personally liable for the corporation's taxes if (1) the individual had the control, supervision or responsibility of

² The sole issue presented in this case pursuant to the pre-trial order agreed to by the parties entered on May 2, 2007 is whether John Doe "willfully failed to pay Retailers' Occupation and/or Use Tax to the Illinois Department of Revenue as set forth on Notice of Penalty Liability No. 8781 ... [.]".

filing the sales tax returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

Under section 3-7, the Department's certified record relating to the penalty liability constitutes *prima facie* proof of the correctness of the penalty due. 35 ILCS 735/3-7(a); Branson at 260. Once the Department presents its *prima facie* case, the burden shifts to the taxpayer to establish that one or more of the elements of the penalty are lacking, that is, that the person charged was not a responsible corporate officer or employee, or that the person's actions were not willful. *Id.* at 261.

For guidance in determining whether a person is responsible under section 3-7, the Illinois Supreme Court has referred to cases interpreting section 6672 of the Internal Revenue Code, 26 U.S.C.A. section 6672.³ Branson at 254-56; Department of Revenue v. Heartland Investments Incorporated, 106 Ill. 2d 19, 29-30 (1985). These Federal cases state that the critical factor in determining responsibility is whether the person had "significant" control over the corporation's finances. Purdy Co. of Illinois v. United States, 814 F. 2d 1183, 1188 (7th Circuit 1987). A key indicia of such control is participation in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F. 2d 1210 (7th Circuit 1970), cert. denied, 400 U.S. 821 (1970). Significant control does not mean exclusive or absolute control over the dispersal of funds. Thomas v. U.S., 41 F. 3d 1109, 1113 (7th Cir. 1994). All that is required is that the person could have impeded the misapplication of revenues to pay expenses other than

³ Section 6672 of the Internal Revenue Code imposes penalty liability on corporate officers who willfully fail to collect, account for, or pay over employee Social Security and federal income withholding taxes.

delinquent tax liabilities by preventing the corporation from squandering the taxes that it should have paid to the Department. *Id.*

In the present case, Doe has failed to present sufficient documentary evidence to show that he did not have significant control over the corporation's finances. The record indicates that Doe was the Treasurer of ABC. This corporation's by-laws are not in evidence, and the record does not show what duties and responsibilities were vested in the office of "Treasurer." However, the "Treasurer" of a corporation is usually charged with the financial management of the corporation and, in the absence of any documentary evidence to the contrary, there is no reason to assume that this was not the case with ABC.

In fact, the testimony presented in this case shows that Doe was in charge of important aspects of ABC's financial management. Specifically, Doe testified that his duties included control over the day-to-day operations of this company. This function entailed "routinely" preparing and signing checks to cover the company's day-to-day operating expenses. Tr. pp. 14-16. The record shows that in 2002, ABC's day-to-day operating expenses exceeded \$99,000. Taxpayer's Ex. 3 ("other deductions" schedule to ABC's Federal income tax form 1065). The record further indicates that Doe was also responsible for overseeing the preparation of the company's tax returns⁴ which he executed in his capacity as an officer of the company. Department Ex. 2.

Doe has failed to rebut indicia of significant control over ABC's financial affairs implicit in his status as "Treasurer", his authority to sign checks and his execution of

⁴ On each of the sales tax returns contained in the record, Doe signed his name under a statement that provided "Under penalty of perjury, I state that I have examined this return and to the best of my knowledge, it is true, correct and complete."

ABC's tax returns. Throughout his testimony, Doe attempted to underplay his authority over ABC's financial and tax affairs during the tax period in controversy. However, his testimony as to his lack of responsibility concerning the company's financial affairs and tax compliance is self-serving and therefore unpersuasive. At a minimum he might have called Jane Doe, ABC's President and the person Doe contends exercised authority and control over financial and tax matters (Tr. pp. 10-13, 15-17), to corroborate his claims.

Moreover, even if Doe were able to show that the common practice was to obtain authorization from the company's President before deciding how to meet the company's tax obligations, such proof would not be a dispositive defense to liability in this case. As pointed out in Howard v. United States, 82-2 USTC paragraph 9567 (N.D. Texas 1982), affirmed 711 F. 2d 729 (5th Circuit 1983), in determining whether a taxpayer is a responsible officer, "the question is not whether" the taxpayer "exercised the power he possessed, but rather what power he possessed." Howard at 2. Doe was ABC's Treasurer and exercised responsibility over the preparation and filing of tax returns. Moreover, he had the authority to sign checks drawn on ABC's account, and there is no evidence that these checks needed to be countersigned. Accordingly, it is clear that Doe possessed the ability to refuse to sign checks paying creditors other than Illinois unless and until the taxes held in trust by this company were paid over to the state.

Jane Doe, as President, may indeed have demanded that other creditors be preferred over the state. Indeed she might have been, in some sense, an even more responsible person than Doe. However, the courts have repeatedly held that there may be more than one responsible person in a corporation. Monday, supra; Williams v. United States, 931 F. 2d 805, 810 note 7 (11th Circuit 1991); Roth v. United States, 779 F. 2d

1567, 1571 (4th Circuit 1986) ("There is no dispute ... that more than one person may be a responsible person for an employer."). Accordingly, the fact that Jane Doe, the company's President, may have been "responsible" in no way impinges on the fact that Doe was himself a responsible person within the meaning of 35 ILCS 735/3-7. Howard at 2; Neckles v. United States, 579 F. 2d 938 (5th Circuit 1978). These facts lead to the conclusion that Doe had sufficient authority over the company's finances to have prevented the failure to pay taxes giving rise to the NPL at issue in this case.

The only document that was submitted by Doe to directly rebut the Department's determination that he was a responsible officer was ABC's Illinois registration form NUC-1, which indicates that Jane Doe, the corporation's President, rather than Doe was responsible for filing returns and paying taxes. Taxpayer's Ex. 1. As noted above, although Jane Doe may have indeed been a responsible officer, more than one taxpayer may be found to be responsible. Two or more persons may be jointly or severally liable under section 3-7. McLean v. Department of Revenue, 326 Ill. App. 3d 667, 677 (1st Dist. 2001). The Department is entitled to pursue either responsible person. Id. However, it is not entitled to more than one satisfaction of tax liability. Id. In the instant case, proof that Jane Doe was a responsible person does not preclude a finding that Doe was legally "responsible" pursuant to section 3-7 as well.

In order to overcome the Department's *prima facie* case, it was incumbent upon Doe to present more than his own testimony indicating that he was not a responsible person. A.R. Barnes & Co. at 333-34; Mel-Park Drugs at 217. Although Doe testified that he signed checks only after receiving prior approval from ABC's President to do so, there is absolutely no evidence in the record to suggest that Doe was not legally

authorized to sign checks without any such approval. No bank signatory cards or check approval authorizations were admitted into evidence. Consequently, there is no documentary evidence in the record indicating that Doe did not possess the authority to sign checks without any prior approval.

Moreover, Doe's testimony that he lacked the authority to sign checks without the approval of the company's President is in conflict with Doe's admitted status as an officer and manager of the ABC LLC. As an officer and manager, Doe had the same amount of authority over all aspects of corporate governance as the President pursuant to the Illinois Limited Liability Company Act. 805 **ILCS** 180/15-1.⁵ In sum, because Doe, ABC's Treasurer, had the legal authority to sign checks to pay the corporation's creditors without prior approval, and failed to provide corroborating documentary evidence that he lacked significant control over the corporation's finances that his title and check signing authority ordinarily indicates, the Department's determination that he was a "responsible officer" has not been rebutted by the evidence Doe has submitted.

A second element, willful failure to pay taxes, must be shown in order to impose personal liability in this case. *Id.* The Department presents a *prima facie* case for willfulness with the introduction of the NPL into evidence. Branson, *supra*. The burden then is on the presumptive responsible party to rebut the presumption of willfulness. *Id.* As stated in Newsome v. United States, 431 F. 2d 742 (1970), willfulness does not require a criminal or other bad motive on the part of the responsible person. All that must be shown is a voluntary, conscious and intentional failure to collect, truthfully account

⁵ The Illinois Limited Liability Company Act, 805 **ILCS** 180/1-1 *et seq.*, provides as follows: "each manager has equal rights in the management and conduct of the company's business." 805 **ILCS** 180/15-1(b)(1).

for, and pay over the taxes that are held in trust for the Government. *Id.* at 745. Accordingly, the subjective state of mind of the responsible officer is not determinative.

Willfulness as used in section 3-7 may be indicated where there is a reckless disregard for obvious or known risks. *Monday, supra.* Willfulness also includes "failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government." *Peterson v. United States*, 758 F. Supp. 1209, 1217 (N.D. Ill.1990). A person also acts willfully in failing to pay delinquent taxes if he prefers other creditors to the state. *Heartland Investments, supra.*

Doe's conduct was willful under each of the above tests. The record shows that he was aware that state ROT taxes collected from receipts from customers, and other taxes that were due, were not being timely paid throughout the tax period in controversy. Tr. p. 17; Department Ex. 2. Doe signed returns for the periods November and December 2002 and January 2003, which he submitted to the Department without checks to cover the taxes shown to be due. *Id.* Despite his knowledge of the company's constant failure to comply with the state's tax laws, the record contains no evidence to show what if any steps Doe took to correct the company's tax compliance mismanagement.

Moreover, Doe, by his own admission, continued to prepare and sign checks for expenses other than Retailers' Occupation Tax and related taxes throughout the tax period in controversy even though he knew that these taxes had not been paid. Tr. pp. 16, 17. Checks he signed after the company's failure to timely pay taxes included checks to pay the company's day-to-day operating expenses which fell within his realm of responsibility as manager of operations. *Id.* When asked why he continued to pay non-tax obligations even though Retailers' Occupation and related taxes had not been paid,

Doe responded that he did so because “[Jane Doe, the company’s President] told me she was going to cover the deficiencies ... [.]”. Tr. p. 17.

In relying on such assurances made to him by Jane Doe, Doe recklessly disregarded the obvious risk that taxes due to the state would subsequently not be paid. This risk was certainly clear to Doe by the beginning of 2003 since by then it was clear that, despite her assurances, Jane Doe had failed to pay any amount to cover the delinquent taxes that were due in December.⁶ Such reckless disregard for obvious and known risks is clear indicia of willfulness. Monday, *supra*. Accordingly, for this reason, and for the reasons enumerated above, I find that Doe has failed to rebut the Department’s *prima facie* case that he willfully failed to pay taxes.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department’s Notice of Penalty Liability number 0000 and its Notice of Deficiency number 0000 be affirmed in their entirety.

Ted Sherrod
Administrative Law Judge

Date: October 3, 2007

⁶ ABC’s tax payments for November were due December 20, 2002 pursuant to 35 ILCS 120/3.